

University of Mississippi

eGrove

AICPA Professional Standards

American Institute of Certified Public
Accountants (AICPA) Historical Collection

1972

Proposed Restatement of the Code of Professional Ethics

American Institute of Certified Public Accountants. Division of Professional Ethics

Follow this and additional works at: https://egrove.olemiss.edu/aicpa_prof



Part of the [Accounting Commons](#), and the [Taxation Commons](#)

Proposed Restatement of the Code of Professional Ethics

Membership approval is required only for the enforceable
Rules of Conduct printed on the colored pages 20 to 27.

**Division of Professional Ethics
of the
American Institute of Certified Public Accountants**

Proposed Restatement of the Code of Professional Ethics

**Division of Professional Ethics
of the
American Institute of Certified Public Accountants**

*Copyright 1972 by the American Institute of Certified Public Accountants, Inc.
666 Fifth Avenue, New York, New York 10019*

Contents

	<i>Page</i>
Introduction	1
Foreword	5
Concepts of Professional Ethics	7
Rules of Conduct	19
Interpretations of Rules of Conduct	33

Introduction

This document consists of three parts. The first part, the *Concepts of Professional Ethics*, is a philosophical essay approved by the Division of Professional Ethics. It is not intended to establish enforceable standards since it suggests behavior beyond what is called for in the Rules of Conduct.

The second part, the *Rules of Conduct*, consists of enforceable ethical standards and requires the approval of the membership before the Rules would become effective. It is printed on colored pages to facilitate identification.

The third part, *Interpretations of Rules of Conduct*, consists of interpretations which have been adopted prospectively by the Division of Professional Ethics to take the place of the present Opinions of the Ethics Division upon adoption of the restated Rules of Conduct.

The following are the major changes of substance from the present Code:

Definitions. This section offers guidance as to the intent with which certain words are used throughout the Code. No similar section is in the present Code and the precise meaning of some terms presently used is ambiguous. While for the most part the definitions reflect traditional meanings, the "practice of public accounting" has been defined as holding oneself out to be a CPA or public accountant and at the same time performing for a client one or more types of services rendered by public accountants. In

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

1 the past, application of the Code did not depend on whether or
2 not a member held himself out as a CPA.

3 **Applicability of rules.** This section is also new and clarifies the
4 application of the rules to members not in public practice and to
5 those practicing outside the United States. It also clarifies a mem-
6 ber's responsibility for acts of others on his behalf.

7 **Rule 101—Independence.** This rule incorporates the major
8 provisions of the present Rule 1.01 on independence and adds the
9 following conditions which will impair independence:

- 10 1. Certain loans with clients.
- 11 2. Material joint closely held business investments with clients.
- 12 3. Service as a trustee for any pension or profit-sharing trust
13 of an enterprise, or as a trustee or executor for a deceased client
14 where the trust or estate has a direct or material indirect financial
15 interest in a client. A delay of two years in effectiveness permits
16 an orderly transition of client relationships.

17 Interpretation 101-1 (page 34) clarifies the exception for hon-
18 orary directorships of charities.

19 **Rule 102—Integrity and objectivity.** This rule is new and
20 stresses that a member must act truthfully and objectively in per-
21 forming services and shall not subordinate his judgment to others.

22 **Rule 201—Competence.** This rule, providing simply that a
23 member should not undertake any engagement which he or his
24 firm cannot reasonably expect to complete with professional com-
25 petence, is new.

26 **Rule 202—Auditing standards, and Rule 203—Accounting**
27 **principles.** These two rules would substitute for Rules 2.01
28 through 2.03 of the present Code. The present rules make no
29 mention of the generally accepted auditing standards or APB
30 Opinions. Proposed Rule 202 would require adherence to the
31 generally accepted auditing standards adopted by the membership
32 in 1948 and 1949 and would clarify the enforceability of State-
33 ments on Auditing Procedure issued by the Institute's auditing
34 procedure committee.

35 Proposed Rule 203 would prohibit a member from expressing
36 his opinion that financial statements are presented in conformity

INTRODUCTION

with generally accepted accounting principles if such statements depart in a material respect from an APB Opinion unless he can demonstrate that due to unusual circumstances the departure is necessary to a fair presentation—in which case his report must describe the departure, the approximate effects thereof, if practicable, and the reasons why compliance with the Opinion would not result in a fair statement.

Rule 301—Confidential client information. This rule is a restatement and elaboration of the present rule, which provides simply that a member may not “violate the confidential relationship between himself and his client.” The restatement makes clear the purpose of the rule and illustrates circumstances in which it would not apply. In addition, it specifically covers the responsibility of the ethics division, Trial Board and quality review personnel to keep confidential the information they receive in the course of their work.

Rule 401—Encroachment. This rule combines and restates the provisions of present Rules 5.01, on encroachment, and 5.02, on referrals, and clarifies the propriety of a member’s insistence on auditing any subsidiary, branch or other component of a client as he deems necessary when expressing an opinion on consolidated statements.

It also provides that when an audit client of another independent public accountant requests a member to provide professional advice on accounting or auditing matters in connection with an expression of an opinion on financial statements, the member must first consult with the other accountant to be sure he is aware of all the available relevant facts.

Rule 402—Offers of employment. This rule broadens present Rule 5.03 to require notice to a practitioner-employer of offers of employment made on behalf of a client. The present rule is silent on whether it applies to such offers, or is limited only to offers made on behalf of the member himself.

Rule 502—Solicitation and advertising. This rule combines present Rules 3.01, on advertising, and 3.02, on solicitation.

Rule 503—Commissions. This rule would prohibit payment of a commission to anyone to obtain a client, and receipt of a commission from anyone for referral to a client of products or

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

1 services of others. Present Rule 3.04 permits such payments
2 where other practitioners are involved.

3 **Rule 504—Incompatible occupations.** This rule clarifies Rule
4 4.04, on incompatible occupations, by specifying that a practi-
5 tioner may not engage in an occupation which impairs his objec-
6 tivity in rendering professional services or serves as a feeder to
7 his accounting practice.

8 **Rule 505—Form of practice and name.** This rule combines
9 Rule 4.06 on practice in corporate form, the substance of Rule
10 4.02, on practice in the name of another, and Rule 4.01, on
11 designation as "Members of the American Institute of CPAs."

12 In addition to the foregoing comparisons, the proposed Code
13 does not include Rule 3.03, on competitive bidding, because legal
14 counsel has advised that its enforcement or restatement could
15 subject the Institute to risks under the federal antitrust laws. To
16 prevent misunderstanding that this change entirely removes fees
17 from ethical considerations, it should be noted that the rule
18 against solicitation remains unchanged in substance in the pro-
19 posed Code and that in some circumstances the quotation of inade-
20 quate fees would be evidence of solicitation. (See Interpretation
21 502-14, page 42.)

22 Rule 4.03, prohibiting a member from permitting an employee
23 to perform services he himself is not permitted to perform, has
24 been dropped since public laws contain the same prohibition and
25 its inclusion as a rule is unnecessary.

Foreword

More than half a century ago, the Council of the American Institute of Certified Public Accountants adopted eight Rules of Conduct. Since then the number of rules has multiplied and, in addition, the committee on professional ethics has issued numerous interpretive opinions to guide members in resolving ethical problems.

During this period the ranks of certified public accountants have increased greatly, and the scope and influence of the profession have dramatically broadened. Also, as society has become more complex and sophisticated, public expectations of appropriate conduct on the part of public officials, corporate executives and others occupying positions of trust have risen sharply.

Such developments, within accountancy itself and in society generally, led to suggestions that a study be undertaken to determine the adequacy of the Code of Professional Ethics in today's environment, and that the Code be revised and updated if necessary.

Accordingly, the committee on professional ethics, under the chairmanship of Thomas D. Flynn, established early in 1968 a Code revision subcommittee, which immediately began an examination not only of the Code of the American Institute but also of pertinent literature, including the ethical codes of accounting societies in other countries and the codes of other professional bodies.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

1 It was soon determined, among other things, that pronounce-
2 ments by technical committees of the Institute since the last pre-
3 vious restatement of the Code in 1962 had made some of its sec-
4 tions obsolete, that many interpretive opinions dealt with the same
5 subjects but in piecemeal fashion and that some crucial phrases in
6 the Code were not well defined. Furthermore, new developments,
7 such as the greatly increased use of computers in accounting,
8 raised ethical questions that had not been contemplated in earlier
9 periods.

10 In October 1968, a committee on Code restatement was ap-
11 pointed. Successive drafts reflected continuing deliberations of the
12 committee and reviews by other Institute committees in the light
13 of their particular areas of interest. In July 1970, a draft of the
14 restated Code was submitted to the Board of Directors, which ap-
15 proved the exposure of the proposed restatement to the fall meet-
16 ing of Council, to state CPA societies and to other interested
17 parties. A second exposure took place in the summer of 1971.

18 The revised Code incorporates many of the suggestions received
19 by the committee in response to these exposures.

20 A code of ethics, comprehensive in scope, suited to practical
21 application and elevated in aim, serves not only as a guide to
22 practitioners in dealing with questions that are often complex; it
23 is also assurance for the public. And it evidences to young persons
24 of talent and ideals that accountancy offers ample opportunity to
25 achieve personal growth, to earn the respect of the community
26 and to contribute to the well-being of society.

27 Finally, the committee wishes to make clear that it approached
28 its assignment with full consciousness that a code, by itself, cannot
29 produce ethical behavior. That comes from a person's inherent
30 character. As was said by Marcus Aurelius, "A man should *be*
31 upright; not be *kept* upright."

Concepts of Professional Ethics

	<i>Page</i>
Independence, integrity and objectivity	10
Competence and technical standards	13
Responsibilities to clients	14
Responsibilities to colleagues	15
Other responsibilities and practices	16

Concepts of Professional Ethics

1 A distinguishing mark of a professional is his acceptance of
2 responsibility to the public. All true professions have therefore
3 deemed it essential to promulgate codes of ethics and to establish
4 means for ensuring their observance.

5 The reliance of the public, the government and the business
6 community on sound financial reporting and advice on business
7 affairs, and the importance of these matters to the economic and
8 social aspects of life impose particular obligations on certified
9 public accountants.

10 Ordinarily those who depend upon a certified public accountant
11 find it difficult to assess the quality of his services; they have a
12 right to expect, however, that he is a person of competence and
13 integrity. A man or woman who enters the profession of account-
14 ancy is assumed to accept an obligation to uphold its principles,
15 to work for the increase of knowledge in the art and for the im-
16 provement of methods, and to abide by the profession's ethical and
17 technical standards.

18 The ethical Code of the American Institute emphasizes the pro-
19 fession's responsibility to the public, a responsibility that has
20 grown as the number of investors has grown, as the relationship
21 between corporate managers and stockholders has become more

CONCEPTS OF PROFESSIONAL ETHICS

impersonal and as government increasingly relies on accounting information.

The Code also stresses the CPA's responsibility to clients and colleagues, since his behavior in these relationships cannot fail to affect the responsibilities of the profession as a whole to the public.

The Institute's Rules of Conduct set forth minimum levels of acceptable conduct and are mandatory and enforceable. However, it is in the best interests of the profession that CPAs strive for conduct beyond that indicated merely by prohibitions. Ethical conduct, in the true sense, is more than merely abiding by the letter of explicit prohibitions. Rather it requires unswerving commitment to honorable behavior, even at the sacrifice of personal advantage.

The conduct toward which CPAs should strive is embodied in five broad concepts stated as affirmative Ethical Principles:

Independence, integrity and objectivity. A certified public accountant should maintain his integrity and objectivity and, when engaged in the practice of public accounting, be independent of those he serves.

Competence and technical standards. A certified public accountant should observe the profession's technical standards and strive continually to improve his competence and the quality of his services.

Responsibilities to clients. A certified public accountant should be fair and candid with his clients and serve them to the best of his ability, with professional concern for their best interests, consistent with his responsibilities to the public.

Responsibilities to colleagues. A certified public accountant should conduct himself in a manner which will promote cooperation and good relations among members of the profession.

Other responsibilities and practices. A certified public accountant should conduct himself in a manner which will enhance the stature of the profession and its ability to serve the public.

The foregoing Ethical Principles are intended as broad guidelines as distinguished from enforceable Rules of Conduct. Even though they do not provide a basis for disciplinary action, they constitute the philosophical foundation upon which the Rules of Conduct are based.

The following discussion is intended to elaborate on each of the Ethical Principles and provide rationale for their support.

1 Independence, integrity and objectivity

2 *A certified public accountant should maintain his integrity and*
3 *objectivity and, when engaged in the practice of public accounting,*
4 *be independent of those he serves.*

5 The public expects a number of character traits in a certified
6 public accountant but primarily integrity and objectivity and, in
7 the practice of public accounting, independence.

8 Independence has always been a concept fundamental to the
9 accounting profession, the cornerstone of its philosophical struc-
10 ture. For no matter how competent any CPA may be, his opinion
11 on financial statements will be of little value to those who rely on
12 him—whether they be clients or any of his unseen audience of
13 credit grantors, investors, governmental agencies and the like—
14 unless he maintains his independence.

15 Independence has traditionally been defined by the profession
16 as the ability to act with integrity and objectivity.

17 Integrity is an element of character which is fundamental to
18 reliance on the CPA. This quality may be difficult to judge, how-
19 ever, since a particular fault of omission or commission may be
20 the result either of honest error or a lack of integrity.

21 Objectivity refers to a CPA's ability to maintain an impartial
22 attitude on all matters which come under his review. Since this
23 attitude involves an individual's mental processes, the evaluation
24 of objectivity must be based largely on actions and relationships
25 viewed in the context of ascertainable circumstances.

26 While recognizing that the qualities of integrity and objectivity
27 are not precisely measurable, the profession nevertheless con-
28 stantly holds them up to members as an imperative. This is done
29 essentially by education and by the Rules of Conduct which the
30 profession adopts and enforces.

31 CPAs cannot practice their calling and participate in the world's
32 affairs without being exposed to situations that involve the pos-
33 sibility of pressures upon their integrity and objectivity. To define
34 and proscribe all such situations would be impracticable. To ignore
35 the problem for that reason, however, and to set no limits at all
36 would be irresponsible.

37 It follows that the concept of independence should not be in-
38 terpreted so loosely as to permit relationships likely to impair
39 the CPA's integrity or the impartiality of his judgment, nor so
40 strictly as to inhibit the rendering of useful services when the
41 likelihood of such impairment is relatively remote.

CONCEPTS OF PROFESSIONAL ETHICS

While it may be difficult for a CPA always to appear completely independent even in normal relationships with clients, pressures upon his integrity or objectivity are offset by powerful countervailing forces and restraints. These include the possibility of legal liability, professional discipline ranging up to revocation of the right to practice as a CPA, loss of reputation and, by no means least, the inculcated resistance of a disciplined professional to any infringement upon his basic integrity and objectivity. Accordingly, in deciding which types of relationships should be specifically prohibited, both the magnitude of the threat posed by a relationship and the force of countervailing pressures have to be weighed.

In establishing rules relating to independence, the profession uses the criterion of whether reasonable men, having knowledge of all the facts and taking into consideration normal strength of character and normal behavior under the circumstances, would conclude that a specified relationship between a CPA and a client poses an unacceptable threat to the CPA's integrity or objectivity.

When a CPA expresses an opinion on financial statements, not only the fact but also the appearance of integrity and objectivity is of particular importance. For this reason, the profession has adopted rules to prohibit the expression of such an opinion when relationships exist which might pose such a threat to integrity and objectivity as to exceed the strength of countervailing forces and restraints. These relationships fall into two general categories: (1) certain financial relationships with clients and (2) relationships in which a CPA is virtually part of management or an employee under management's control.

Although the appearance of independence is not required in the case of management advisory services and tax practice, a CPA is encouraged to avoid the proscribed relationships with clients regardless of the type of services being rendered. In any event, the CPA, in all types of engagements, should refuse to subordinate his professional judgment to others and should express his conclusions honestly and objectively.

The financial relationships proscribed when an opinion is expressed on financial statements make no reference to fees paid to a CPA by a client. Remuneration to providers of services is necessary for the continued provision of those services. Indeed, a principal reason for the development and persistence in the professions of the client-practitioner relationship and of remuneration by fee (as contrasted with an employer-employee relationship and

remuneration by salary) is that these arrangements are seen as a safeguard of independence.

The above reference to an employer-employee relationship is pertinent to a question sometimes raised as to whether a CPA's objectivity in expressing an opinion on financial statements will be impaired by his being involved with his client in the decision-making process.

CPAs continually provide advice to their clients, and they expect that this advice will usually be followed. Decisions based on such advice may have a significant effect on a client's financial condition or operating results. This is the case not only in tax engagements and management advisory services but in the audit function as well.

If a CPA disagrees with a client on a significant matter during the course of an audit, the client has three choices—he can modify the financial statements (which is usually the case), he can accept a qualified report or he can discharge the CPA. While the ultimate decision and the resulting financial statements clearly are those of the client, the CPA has obviously been a significant factor in the decision-making process. Indeed, no responsible user of financial statements would want it otherwise.

It must be noted that when a CPA expresses an opinion on financial statements, the judgments involved pertain to whether the results of operating decisions of the client are fairly presented in the statements and not on the underlying wisdom of such decisions. It is highly unlikely therefore that being a factor in the client's decision-making process would impair the CPA's objectivity in judging the fairness of presentation.

The more important question is whether a CPA would deliberately compromise his integrity by expressing an unqualified opinion on financial statements which were prepared in such a way as to cover up a poor business decision by the client and on which the CPA had rendered advice. The basic character traits of the CPA as well as the risks arising from such a compromise of integrity, including liability to third parties, disciplinary action and loss of right to practice, should preclude such action.

Providing advice or recommendations which may or may not involve skills logically related to a client's information and control system, and which may affect the client's decision-making, does not in itself indicate lack of independence. However, the CPA must be alert to the possibility that undue identification with the management of the client or involvement with a client's affairs to

CONCEPTS OF PROFESSIONAL ETHICS

such a degree as to place him virtually in the position of being an employee, may impair the appearance of independence.

To sum up, CPAs cannot avoid external pressures on their integrity and objectivity in the course of their professional work, but they are expected to resist these pressures. They must, in fact, retain their integrity and objectivity in all phases of their practice and, when expressing opinions on financial statements, avoid involvement in situations that would impair the credibility of their independence in the minds of reasonable men familiar with the facts.

Competence and technical standards

A certified public accountant should observe the profession's technical standards and strive continually to improve his competence and the quality of his services.

Since accounting information is of great importance to all segments of the public, all CPAs, whether in public practice, government service, private employment or academic pursuits, should perform their work at a high level of professionalism.

A CPA should maintain and seek always to improve his competence in all areas of accountancy in which he engages. Satisfaction of the requirements for the CPA certificate is evidence of basic competence at the time the certificate is granted, but it does not justify an assumption that this competence is maintained without continuing effort. Further, it does not necessarily justify undertaking complex engagements without additional study and experience.

A CPA should not render professional services without being aware of, and complying with, the applicable technical standards. Moreover, since published technical standards can never cover the whole field of accountancy, he must keep broadly informed.

Observance of the rule on competence calls for a subjective determination by a CPA with respect to each engagement. Some engagements will require a higher level of knowledge, skill and judgment than others. Competence to deal with an unfamiliar problem may be acquired by research, study or consultation with a practitioner who has the necessary competence. If a CPA is unable to gain sufficient competence through these means, he should suggest, in fairness to his client and the public, the engagement of someone competent to perform the needed service, either independently or as an associate.

1 The standards referred to in the rules are elaborated and re-
2 fined to meet changing conditions, and it is each CPA's responsi-
3 bility to keep himself up to date in this respect.

4 **Responsibilities to clients**

5 *A certified public accountant should be fair and candid with his*
6 *clients and serve them to the best of his ability, with professional*
7 *concern for their best interests, consistent with his responsibilities*
8 *to the public.*

9 As a professional person, the CPA should serve his clients
10 with competence and with professional concern for their best
11 interests. He must not permit his regard for a client's interest, how-
12 ever, to override his obligation to the public to maintain his inde-
13 pendence, integrity and objectivity. The discharge of this dual
14 responsibility to both clients and the public requires a high degree
15 of ethical perception and conduct.

16 It is fundamental that the CPA hold in strict confidence all in-
17 formation concerning a client's affairs which he acquires in the
18 course of his engagement. This does not mean, however, that he
19 should acquiesce in a client's unwillingness to make disclosures in
20 financial reports which are necessary to fair presentation.

21 Exploitation of relations with a client for personal advantage is
22 improper. For example, acceptance of a commission from any
23 vendor for recommending his product or service to a client is pro-
24 hibited.

25 A CPA should be frank and straightforward with clients. While
26 tact and diplomacy are desirable, a client should never be left in
27 doubt about the CPA's position on any issue of significance. No
28 truly professional man will subordinate his own judgment or con-
29 ceal or modify his honest opinion merely to please. This admoni-
30 tion applies to all services including those related to management
31 and tax problems.

32 When accepting an engagement, a CPA should bear in mind
33 that he may find it necessary to resign if conflict arises on an im-
34 portant question of principle. In cases of irreconcilable differ-
35 ence, he will have to judge whether the importance of the matter
36 requires such an action. In weighing this question, he can feel
37 assured that the practitioner who is independent, fair and candid
38 is the better respected for these qualities and will not lack oppor-
39 tunities for constructive service.

Responsibilities to colleagues

A certified public accountant should conduct himself in a manner which will promote cooperation and good relations among members of the profession.

The support of a profession by its members and their cooperation with one another are essential elements of professional character. The public confidence and respect which a CPA enjoys is largely the result of the cumulative accomplishments of all CPAs, past and present. It is, therefore, in the CPA's own interest, as well as that of the general public, to support the collective efforts of colleagues through professional societies and organizations and to deal with fellow practitioners in a manner which will not detract from their reputation and well-being.

Although the reluctance of a professional to give testimony that may be damaging to a colleague is understandable, the obligation of professional courtesy and fraternal consideration can never excuse lack of complete candor if the CPA is testifying as an expert witness in a judicial proceeding or properly constituted inquiry.

A CPA has the obligation to assist his fellows in complying with the Code of Professional Ethics and should also assist appropriate disciplinary authorities in enforcing the Code. To condone serious fault can be as bad as to commit it. It may be even worse, in fact, since some errors may result from ignorance rather than intent and, if let pass without action, will probably be repeated. In situations of this kind, the welfare of the public should be the guide to a member's action.

While the Code proscribes certain specific actions in the area of relationships with colleagues, it should be understood that these proscriptions do not define the limits of desirable intraprofessional conduct. Rather, such conduct encompasses the professional consideration and courtesies which each CPA would like to have fellow practitioners extend to him.

It is natural that a CPA will seek to develop his practice. However, in doing so he should not seek to displace another accountant in a client relationship, or act in any way that reflects negatively on fellow practitioners.

A CPA may, of course, provide services to those who request it, even though they may be served by another practitioner in another area of service, or he may succeed another practitioner at a client's request. In such circumstances it is desirable before accepting an engagement that the CPA who has been approached should advise

1 the accountant already serving the client. Such action is indicated
2 not only by considerations of professional courtesy but by good
3 business judgment.

4 A client may sometimes request services requiring highly spe-
5 cialized knowledge. If the CPA lacks the expertise necessary to
6 render such services, he should call upon a fellow practitioner for
7 assistance or refer the entire engagement to another. Such assistance
8 or referral brings to bear on the client's needs both the referring
9 practitioner's knowledge of the client's affairs and the technical
10 expertise of the specialist brought into the engagement. The rules
11 encourage referrals by helping to protect the client relationships
12 of the referring practitioner.

13 **Other responsibilities and practices**

14 *A certified public accountant should conduct himself in a man-*
15 *ner which will enhance the stature of the profession and its*
16 *ability to serve the public.*

17 In light of the importance of their function, CPAs and their
18 firms should have a keen consciousness of the public interest and
19 the needs of society. Thus, they should support efforts to achieve
20 equality of opportunity for all, regardless of race, religious back-
21 ground or sex, and should contribute to this goal by their own
22 service relationships and employment practices.

23 The CPA is a beneficiary of the organization and character of
24 his profession. Since he is seen as a representative of the profession
25 by those who come in contact with him, he should behave honor-
26 ably both in his personal and professional life and avoid any con-
27 duct that might erode public respect and confidence.

28 Solicitation to obtain clients is prohibited under the Rules of
29 Conduct because it tends to lessen the professional independence
30 toward clients which is essential to the best interests of the public.
31 It may also induce an unhealthy rivalry within the profession and
32 thus lessen the cooperation among members which is essential to
33 advancing the state of the art of accounting and providing maxi-
34 mum service to the public.

35 Advertising, which is a form of solicitation, is also prohibited
36 because it could encourage representations which might mislead
37 the public and thereby reduce or destroy the profession's useful-
38 ness to society. However, a CPA should seek to establish a reputa-
39 tion for competence and character, and there are many acceptable

CONCEPTS OF PROFESSIONAL ETHICS

means by which this can be done. For example, he may make himself known by public service, by civic and political activities, and by joining associations and clubs. It is desirable for him to share his knowledge with interested groups by accepting requests to make speeches and write articles. Whatever publicity occurs as a natural by-product of such activities is entirely proper. It would be wrong, however, for the CPA to initiate or embellish publicity.

Promotional practices, such as solicitation and advertising, tend to indicate a dominant interest in profit. In his work, the CPA should be motivated more by desire for excellence in performance than for material reward. This does not mean that he need be indifferent about compensation. Indeed, a professional man who cannot maintain a respectable standard of living is unlikely to inspire confidence or to enjoy sufficient peace of mind to do his best work.

In determining fees, a CPA may assess the degree of responsibility assumed by undertaking an engagement as well as the time, manpower and skills required to perform the service in conformity with the standards of the profession. He may also take into account the value of the service to the client, the customary charges of professional colleagues and other considerations. No single factor is necessarily controlling.

On occasion, a CPA may appropriately choose to serve a client for a fee less than cost or without fee. However, it would be improper and a form of solicitation to propose an inadequate fee for the purpose of securing an engagement. Although all circumstances that might be relevant in determining the propriety of a particular fee proposal cannot be specified in advance, it would be appropriate to consider whether there were any facts suggesting that such inadequate fee was part of a plan or design to solicit business. In such cases there might be a temptation to minimize losses by reducing the amount of work below that required by the standards of the profession.

Clients have a right to know in advance what rates will be charged and approximately how much an engagement will cost. However, when professional judgments are involved, it is usually not possible to set a fair charge until an engagement has been completed. For this reason CPAs should state their fees for proposed engagements in the form of estimates which may be subject to change as the work progresses.

Other practices prohibited by the Rules of Conduct include using any firm designation or description which might be misleading, or practicing as a professional corporation or association

1 which fails to comply with provisions established by Council to
2 protect the public interest.

3 A member, while practicing public accounting, may not engage
4 in a business or occupation which is incompatible therewith. While
5 certain occupations are clearly incompatible with the practice of
6 public accounting, the profession has never attempted to list them
7 for in most cases the individual circumstances indicate whether
8 there is a problem. For example, there would be a problem of in-
9 compatibility if a practicing CPA were to sell insurance or securi-
10 ties because these occupations involve solicitation and promo-
11 tional activities which might be used to promote a public account-
12 ing practice. Moreover, they might, under some circumstances,
13 jeopardize the CPA's independence.

14 Paying a commission is prohibited in order to eliminate the
15 temptation to compensate anyone for referring a client. Receipt
16 of a commission is proscribed since practitioners should look to the
17 client, and not to others, for compensation for services rendered.
18 The practice of paying a fee to a referring CPA irrespective of any
19 service performed or responsibility assumed by him is proscribed
20 because there is no justification for a CPA to share in a fee for
21 accounting services where his sole contribution was to make a re-
22 ferral.

23 Over the years the vast majority of CPAs have endeavored to
24 earn and maintain a reputation for competence, integrity and ob-
25 jectivity. The success of these efforts has been largely responsible
26 for the wide public acceptance of accounting as an honorable pro-
27 fession. This acceptance is a valuable asset which should never
28 be taken for granted. Every CPA should constantly strive to see
29 that it continues to be deserved.

Rules of Conduct

	<i>Page</i>
Definitions	20
Applicability of rules	21
Independence, integrity and objectivity	22
Competence and technical standards	24
Responsibilities to clients	25
Responsibilities to colleagues	25
Other responsibilities and practices	26
Appendix A	28
Appendix B	30

Membership approval is required only for the enforceable Rules of Conduct printed on the following colored pages (20-27).

Rules of Conduct

In the footnotes below, the references to specific rules or numbered Opinions indicate that revised sections are derived therefrom; where modifications have been made to the present rule or Opinion, it is noted. The reference to "prior rulings" indicates a position previously taken by the ethics division in response to a specific complaint or inquiry, but not previously published. The reference to "new" indicates a recommendation of the Code Re-statement Committee not found in the present Code or prior rulings of the ethics division.

Definitions

The following definitions of terminology are applicable wherever such terminology is used in the rules and interpretations.

Client. The person(s) or entity which retains a member or his firm, engaged in the practice of public accounting, for the performance of professional services.

Council. The Council of the American Institute of Certified Public Accountants.

Enterprise. Any person(s) or entity, whether organized for profit or not, for which a CPA provides services.

Firm. A proprietorship, partnership or professional corporation or association engaged in the practice of public accounting, including individual partners or shareholders thereof.

Financial statements. Statements and footnotes related thereto that purport to show financial position which relates to a point

RULES OF CONDUCT

in time or changes in financial position which relate to a period of time, and statements which use a cash or other incomplete basis of accounting. Balance sheets, statements of income, statements of retained earnings, statements of changes in financial position and statements of changes in owners' equity, or forecasts thereof, are financial statements.

Incidental financial data included in management advisory services reports to support recommendations to a client, and tax returns and supporting schedules do not, for this purpose, constitute financial statements; and the statement, affidavit or signature of preparers required on tax returns neither constitutes an opinion on financial statements nor requires a disclaimer of such opinion.

Institute. The American Institute of Certified Public Accountants.

Interpretations of Rules of Conduct. Pronouncements issued by the Division of Professional Ethics to provide guidelines as to the scope and application of the Rules of Conduct.

Member. A member, associate member or international associate of the American Institute of Certified Public Accountants.

Practice of public accounting. Holding out to be a CPA or public accountant and at the same time performing for a client one or more types of services rendered by public accountants. The term shall not be limited by a more restrictive definition which might be found in the accountancy law under which a member practices.

Professional services. One or more types of services performed in the practice of public accounting.

Applicability of Rules

The Institute's Code of Professional Ethics derives its authority from the bylaws of the Institute which provide that the Trial Board may, after a hearing, admonish, suspend or expel a member who is found guilty of infringing any of the bylaws or any provisions of the Rules of Conduct.¹

The Rules of Conduct which follow apply to all services performed in the practice of public accounting, including tax² and management advisory services³ except (a) where the wording of

¹ Bylaw Section 7.4.

² Opinion No. 13.

³ Opinion No. 14.

the rule indicates otherwise and (b) that a member who is practicing outside the United States will not be subject to discipline for departing from any of the rules stated herein so long as his conduct is in accord with the rules of the organized accounting profession in the country in which he is practicing.⁴ However, where a member's name is associated with financial statements in such a manner as to imply that he is acting as an independent public accountant and under circumstances that would entitle the reader to assume that United States practices were followed, he must comply with the requirements of Rules 202 and 203.⁵

A member may be held responsible for compliance with the Rules of Conduct by all persons associated with him in the practice of public accounting who are either under his supervision or are his partners or shareholders in the practice.⁶

A member not in public practice must observe the Rules of Conduct except where such rules are specifically limited in their application because they relate solely to the practice of public accounting.⁷

A member shall not permit others to carry out on his behalf, either with or without compensation, acts which, if carried out by the member, would place him in violation of the Rules of Conduct.⁸

Independence, integrity and objectivity

Rule 101—Independence. A member or a firm of which he is a partner or shareholder shall not express an opinion on financial statements of an enterprise unless he and his firm are independent with respect to such enterprise.⁹ Independence will be considered to be impaired if, for example:

- A. During the period of his professional engagement, or at the time of expressing his opinion, he or his firm
 1. Had or was committed to acquire any direct or material indirect financial interest in the enterprise;¹⁰ or

⁴ Prior ruling.

⁵ Rules 2.01, 2.02, 2.03 and prior rulings.

⁶ New.

⁷ New.

⁸ Opinion No. 2.

⁹ Rule 1.01 ("shareholder" added to recognize corporate practice).

¹⁰ Rule 1.01.

RULES OF CONDUCT

2. Had any joint closely held business investment with the enterprise or any officer, director or principal stockholder thereof which was material in relation to his or his firm's net worth; ¹¹ or	1 2 3 4
3. Had any loan to or from the enterprise or any officer, director or principal stockholder thereof. ¹² This latter proscription does not apply to the following loans from a financial institution when made under normal lending procedures, terms and requirements:	5 6 7 8 9
(a) Loans obtained by a member or his firm which are not material in relation to the net worth of such borrower.	10 11 12
(b) Home mortgages.	13
(c) Other secured loans, except loans guaranteed by a member's firm which are otherwise unsecured. ¹³	14 15
B. During the period covered by the financial statements, during the period of the professional engagement or at the time of expressing an opinion, he or his firm	16 17 18
1. Was connected with the enterprise as a promoter, underwriter or voting trustee, a director or officer or in any capacity equivalent to that of a member of management or of an employee; ¹⁴ or	19 20 21 22
2. Was a trustee of any trust or executor or administrator of any estate if such trust or estate had a direct or material indirect financial interest in the enterprise; or was a trustee for any pension or profit-sharing trust of the enterprise. ¹⁵	23 24 25 26 27
The above examples are not intended to be all-inclusive.	28

Rule 102—Integrity and objectivity. A member shall not knowingly misrepresent facts, and when engaged in the practice of public accounting, including the rendering of tax and management advisory services, shall not subordinate his judgment to others.¹⁶

¹¹ Prior rulings.

¹² Prior rulings.

¹³ Opinion No. 19.

¹⁴ Rule 1.01 (present Rule 1.01 uses the phrase "key employee").

¹⁵ Prior rulings. In order that a member may arrange an orderly transition of his relationship with clients, section B2 of Rule 101 relating to trusteeships and executorships will not become effective until two years following the adoption of these Rules of Conduct.

¹⁶ New.

1 In tax practice, a member may resolve doubt in favor of his client
2 as long as there is reasonable support for his position.¹⁷

3 **Competence and technical standards**

4 **Rule 201—Competence.** A member shall not undertake any
5 engagement which he or his firm cannot reasonably expect to com-
6 plete with professional competence.¹⁸

7 **Rule 202—Auditing standards.** A member shall not permit
8 his name to be associated with financial statements in such a man-
9 ner as to imply that he is acting as an independent public ac-
10 countant unless he has complied with the applicable generally ac-
11 cepted auditing standards* promulgated by the Institute. State-
12 ments on Auditing Procedure issued by the Institute's committee
13 on auditing procedure are, for purposes of this rule, considered to
14 be interpretations of the generally accepted auditing standards,
15 and departures from such statements must be justified by those
16 who do not follow them.¹⁹

17 **Rule 203—Accounting principles.** A member shall not express
18 an opinion that financial statements are presented in conformity
19 with generally accepted accounting principles if such statements con-
20 tain any departure from an Opinion of the Accounting Principles
21 Board which has a material effect on the statements taken as a
22 whole, unless the member can demonstrate that due to unusual
23 circumstances the departure is necessary to a fair presentation.
24 In such cases his report must describe the departure, the approxi-
25 mate effects thereof, if practicable, and the reasons why compliance
26 with the Opinion would not result in a fair statement.²⁰

27 **Rule 204—Forecasts.** A member shall not permit his name to
28 be used in conjunction with any forecast of future operations or
29 financial condition in a manner which may lead to the belief that
30 the member vouches for the achievability of the forecast.²¹

* Ten generally accepted auditing standards are listed in Appendix A, page 28.

¹⁷ Opinion No. 13.

¹⁸ New.

¹⁹ New (replaces Rules 2.01-2.03).

²⁰ New (replaces Rules 2.01-2.03).

²¹ Restatement of Rule 2.04.*

Responsibilities to clients

Rule 301—Confidential client information. A member shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client.²²

This rule shall not be construed (a) to relieve a member of his obligation under Rules 202 and 203, (b) to affect in any way his compliance with a validly issued subpoena enforceable by order of a court, (c) to prohibit review of a member's professional practices as a part of voluntary quality review under Institute authorization or (d) to preclude a member from responding to any inquiry made by the ethics division or Trial Board of the Institute, by a duly constituted investigative or disciplinary body of a state CPA society, or under state statutes.²³

Members of the ethics division and Trial Board of the Institute and professional practice reviewers under Institute authorization shall not disclose any confidential client information which comes to their attention from members in disciplinary proceedings or otherwise in carrying out their official responsibilities. However, this prohibition shall not restrict the exchange of information with an aforementioned duly constituted investigative or disciplinary body.²⁴

Rule 302—Contingent fees.²⁵ Professional services shall not be offered or rendered under an arrangement whereby no fee will be charged unless a specified finding or result is attained, or where the fee is otherwise contingent upon the findings or results of such services. However, a member's fees may vary depending, for example, on the complexity of the service rendered.²⁶

Fees are not regarded as being contingent if fixed by courts or other public authorities or, in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies.²⁷

Responsibilities to colleagues

Rule 401—Encroachment.²⁸ A member shall not endeavor to provide a person or entity with a professional service which is cur-

²² Restatement of Rule 1.03.

²³ Prior rulings.

²⁴ New.

²⁵ Restatement of Rule 1.04.

²⁶ New.

²⁷ Rule 1.04.

²⁸ Restatement of Rule 5.01.

rently provided by another public accountant except:

1. He may respond to a request for a proposal to render services and may furnish service to those who request it.²⁹ However, if an audit client of another independent public accountant requests a member to provide professional advice on accounting or auditing matters in connection with an expression of opinion on financial statements, the member must first consult with the other accountant to ascertain that the member is aware of all the available relevant facts.³⁰

2. Where a member is required to express an opinion on combined or consolidated financial statements which include a subsidiary, branch or other component audited by another independent public accountant, he may insist on auditing any such component which in his judgment is necessary to warrant the expression of his opinion.³¹

A member who receives an engagement for services by referral from another public accountant shall not accept the client's request to extend his service beyond the specific engagement without first notifying the referring accountant, nor shall he seek to obtain any additional engagement from the client.³²

Rule 402—Offers of employment. A member in public practice shall not make a direct or indirect offer of employment to an employee of another public accountant on his own behalf or that of his client without first informing such accountant. This rule shall not apply if the employee of his own initiative or in response to a public advertisement applies for employment.³³

Other responsibilities and practices

Rule 501—Acts discreditable. A member shall not commit an act discreditable to the profession.³⁴

Rule 502—Solicitation and advertising. A member shall not

²⁹ Rule 5.01.

³⁰ New.

³¹ Opinion No. 20.

³² Rule 5.02 restated to include prior rulings.

³³ Rule 5.03, "or that of his client" added.

³⁴ Rule 1.02.

RULES OF CONDUCT

seek to obtain clients by solicitation.³⁵ Advertising is a form of solicitation and is prohibited.³⁶

Rule 503—Commissions. A member shall not pay a commission to obtain a client, nor shall he accept a commission for a referral to a client of products or services of others.³⁷ This rule shall not prohibit payments for the purchase of an accounting practice³⁸ or retirement payments to individuals formerly engaged in the practice of public accounting or payments to their heirs or estates.³⁹

Rule 504—Incompatible occupations. A member who is engaged in the practice of public accounting shall not concurrently engage in any business or occupation which impairs his objectivity in rendering professional services or serves as a feeder to his practice.⁴⁰

Rule 505—Form of practice and name. A member may practice public accounting, whether as an owner or employee, only in the form of a proprietorship, a partnership or a professional corporation whose characteristics conform to resolutions of Council.⁴¹ (See Appendix B, page 30.)

A member shall not practice under a firm name which includes any fictitious name, indicates specialization or is misleading as to the type of organization (proprietorship, partnership or corporation).⁴² However, names of one or more past partners or shareholders may be included in the firm name of a successor partnership or corporation.⁴³ Also, a partner surviving the death or withdrawal of all other partners may continue to practice under the partnership name for up to two years after becoming a sole practitioner.⁴⁴

A firm may not designate itself as "Members of the American Institute of Certified Public Accountants" unless all of its partners or shareholders are members of the Institute.⁴⁵

³⁵ Rule 3.02.

³⁶ Rule 3.01.

³⁷ Restatement of Rule 3.04.

³⁸ Prior rulings.

³⁹ Opinion No. 6.

⁴⁰ Restatement of Rule 4.04.

⁴¹ Rule 4.06.

⁴² Prior rulings.

⁴³ Rule 4.02.

⁴⁴ Prior rulings.

⁴⁵ Rule 4.01.

Appendix A

Generally accepted auditing standards

as adopted by the membership in 1948 and 1949

General standards

1. The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor.

2. In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.

3. Due professional care is to be exercised in the performance of the examination and the preparation of the report.

Standards of field work

1. The work is to be adequately planned and assistants, if any, are to be properly supervised.

2. There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.

3. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.

APPENDIX A

Standards of reporting

1. The report shall state whether the financial statements are presented in accordance with generally accepted principles of accounting.
2. The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.
3. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.
4. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clearcut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.

Appendix B

1 *The following resolution of Council was approved at the spring*
2 *meeting of Council on May 6, 1969:*

- 3 RESOLVED, that members may be officers, directors, stock-
4 holders, representatives or agents of a corporation offering services
5 of a type performed by public accountants only when the profes-
6 sional corporation or association has the following characteristics:
- 7 1. *Name.* The name under which the professional corpora-
8 tion or association renders professional services shall contain only
9 the names of one or more of the present or former shareholders or
10 of partners who were associated with a predecessor accounting
11 firm. Impersonal or fictitious names, as well as names which indi-
12 cate a speciality, are prohibited.
- 13 2. *Purpose.* The professional corporation or association shall
14 not provide services that are incompatible with the practice of pub-
15 lic accounting.
- 16 3. *Ownership.* All shareholders of the corporation or associa-
17 tion shall be persons duly qualified to practice as a certified public
18 accountant in a state or territory of the United States or the Dis-
19 trict of Columbia. Shareholders shall at all times own their shares
20 in their own right, and shall be the beneficial owners of the equity
21 capital ascribed to them.
- 22 4. *Transfer of Shares.* Provision shall be made requiring any
23 shareholder who ceases to be eligible to be a shareholder to dis-
24 pose of all of his shares within a reasonable period to a person
25 qualified to be a shareholder or to the corporation or association.

APPENDIX B

5. *Directors and Officers.* The principal executive officer shall be a shareholder and a director, and to the extent possible, all other directors and officers shall be certified public accountants. Lay directors and officers shall not exercise any authority whatsoever over professional matters.

6. *Conduct.* The right to practice as a corporation or association shall not change the obligation of its shareholders, directors, officers and other employees to comply with the standards of professional conduct established by the American Institute of Certified Public Accountants.

7. *Liability.* The stockholders of professional corporations or associations shall be jointly and severally liable for the acts of a corporation or association, or its employees—except where professional liability insurance is carried, or capitalization is maintained, in amounts deemed sufficient to offer adequate protection to the public. Liability shall not be limited by the formation of subsidiary or affiliated corporations or associations each with its own limited and unrelated liability.

In a report approved by Council at the fall 1969 meeting, the Board of Directors recommended that professional liability insurance or capitalization in the amount of \$50,000 per shareholder/officer and professional employee to a maximum of \$2,000,000 would offer adequate protection to the public. Members contemplating the formation of a corporation under this rule should ascertain that no further modifications in the characteristics have been made.

Interpretations of Rules of Conduct

	<i>Page</i>
Interpretations under Rule 101—Independence	34
Interpretation under Rule 201—Competence	36
Interpretation under Rule 204—Forecasts	37
Interpretation under Rule 401—Encroachment	37
Interpretations under Rule 502—Solicitation and advertising	38
Interpretation under Rule 505—Form of practice and name	43

Interpretations of Rules of Conduct

1 *Interpretations of the Rules of Conduct are issued by the Divi-*
2 *sion of Professional Ethics to provide guidelines as to the scope*
3 *and application of such rules. Members who depart from such*
4 *guidelines shall have the burden of justifying such departure in any*
5 *disciplinary hearing.*

6 **Interpretations under Rule 101—Independence**

7 **101-1—Directorships.** Members are often asked to lend the pres-
8 tice of their name as a director of a charitable, religious, civic or
9 other similar type of nonprofit organization whose board is large
10 and representative of the community's leadership. An auditor who
11 permits his name to be used in this manner would not be consid-
12 ered lacking in independence under Rule 101 so long as he does
13 not perform or give advice on management functions, and the
14 board itself is sufficiently large that a third party would conclude
15 that his membership was honorary.⁴⁶

16 **101-2—Retired partners and firm independence.** A retired
17 partner having a relationship of a type specified in Rule 101 with
18 a client of his former firm would not be considered as impairing
19 the firm's independence with respect to the client provided that he
20 is no longer active in the firm, that the fees received from such client

⁴⁶ Rule 1.01.

INTERPRETATIONS OF RULES OF CONDUCT

do not have a material effect on his retirement benefits and that he is not held out as being associated with his former partnership.⁴⁷

101-3—Accounting services.⁴⁸ Members in public practice are sometimes asked to provide manual or automated bookkeeping or data processing services to clients who are of insufficient size to employ an adequate internal accounting staff. Computer systems design and programming assistance are also rendered by members either in conjunction with data processing services or as a separate engagement. Members who perform such services and who are engaged in the practice of public accounting are subject to the by-laws and Rules of Conduct.

On occasion members also rent “block time” on their computers to their clients but are not involved in the processing of transactions or maintaining the client’s accounting records. In such cases the sale of block time constitutes a business rather than a professional relationship and must be considered together with all other relationships between the member and his client to determine if their aggregate impact is such as to impair the member’s independence.

When a member performs manual or automated bookkeeping services, concern may arise whether the performance of such services would impair his audit independence—that the performance of such basic accounting services would cause his audit to be lacking in a review of mechanical accuracy or that the accounting judgments made by him in recording transactions may somehow be less reliable than if made by him in connection with the subsequent audit.

Members are skilled in, and well accustomed to, applying techniques to control mechanical accuracy, and the performance of the record-keeping function should have no effect on application of such techniques. With regard to accounting judgments, if third parties have confidence in a member’s judgment in performing an audit, it is difficult to contend that they would have less confidence where the same judgment is applied in the process of preparing the underlying accounting records.

Nevertheless, a member performing accounting services for an audit client must meet the following requirements to retain the appearance that he is not virtually an employee and therefore lacking in independence in the eyes of a reasonable observer.

⁴⁷ Opinion No. 16.

⁴⁸ Restatement of Opinion No. 22.

1 1. The CPA must not have any relationship or combination of
2 relationships with the client or any conflict of interest which would
3 impair his integrity and objectivity.

4 2. The client must accept the responsibility for the financial
5 statements as his own. A small client may not have anyone in his
6 employ to maintain accounting records and may rely on the CPA
7 for this purpose. Nevertheless, the client must be sufficiently knowl-
8 edgeable of the enterprise's activities and financial condition and
9 the applicable accounting principles so that he can reasonably ac-
10 cept such responsibility, including, specifically, fairness of valua-
11 tion and presentation and adequacy of disclosure. When necessary,
12 the CPA must discuss accounting matters with the client to be sure
13 that the client has the required degree of understanding.

14 3. The CPA must not assume the role of employee or of man-
15 agement conducting the operations of an enterprise. For example,
16 the CPA shall not consummate transactions, have custody of assets
17 or exercise authority on behalf of the client. The client must pre-
18 pare the source documents on all transactions in sufficient detail
19 to identify clearly the nature and amount of such transactions and
20 maintain an accounting control over data processed by the CPA
21 such as control totals and document counts. The CPA should not
22 make changes in such basic data without the concurrence of the
23 client.

24 4. The CPA, in making an examination of financial statements
25 prepared from books and records which he has maintained com-
26 pletely or in part, must conform to generally accepted auditing
27 standards. The fact that he has processed or maintained certain
28 records does not eliminate the need to make sufficient audit tests.

29 When a client's securities become subject to regulation by the
30 Securities and Exchange Commission or other federal or state
31 regulatory body, responsibility for maintenance of the accounting
32 records, including accounting classification decisions, must be as-
33 sumed by accounting personnel employed by the client. The as-
34 sumption of this responsibility must commence with the first fiscal
35 year after which the client's securities qualify for such regulation.

36 **Interpretation under Rule 201—Competence**

37 **201-1—Competence.** A member who accepts a professional
38 engagement implies that he has the necessary competence to com-
39 plete the engagement according to professional standards, applying
40 his knowledge and skill with reasonable care and diligence, but

INTERPRETATIONS OF RULES OF CONDUCT

he does not assume a responsibility for infallibility of knowledge or judgment. 1
2

Competence in the practice of public accounting involves both 3
the technical qualifications of the member and his staff and his 4
ability to supervise and evaluate the quality of the work performed. 5
Competence relates both to knowledge of the profession's stan- 6
dards, techniques and the technical subject matter involved, and 7
to the capability to exercise sound judgment in applying such 8
knowledge to each engagement. 9

The member may have the knowledge required to complete an 10
engagement professionally before undertaking it. In many cases, 11
however, additional research or consultation with others may be 12
necessary during the course of the engagement. This does not 13
ordinarily represent a lack of competence, but rather is a normal 14
part of the professional conduct of an engagement. 15

However, if a CPA is unable to gain sufficient competence 16
through these means, he should suggest, in fairness to his client 17
and the public, the engagement of someone competent to perform 18
the needed service, either independently or as an associate.⁴⁹ 19

Interpretation under Rule 204—Forecasts 20

204-1—Forecasts. Rule 204 does not prohibit a member from 21
preparing, or assisting a client in the preparation of, forecasts of 22
the results of future operations or financial condition. When a 23
member's name is associated with such forecasts, there shall be 24
the presumption that such data may be used by parties other than 25
the client. Therefore, full disclosure must be made of the sources 26
of the information used and the major assumptions made in the 27
preparation of the statements and analyses, the character of the 28
work performed by the member, and the degree of the responsi- 29
bility he is taking.⁵⁰ 30

Interpretation under Rule 401—Encroachment 31

401-1—Relations with clients also served by other public ac- 32
countants. The unsolicited sending to clients of firm literature or 33
invitations to seminars which cover services that are currently being 34
rendered to the client by another public accountant is considered 35
a violation of Rule 401.⁵¹ 36

⁴⁹ New.

⁵⁰ Opinion No. 10.

⁵¹ Opinion No. 20.

**Interpretations under Rule 502—Solicitation
and advertising**

502-1—Announcements. Publication in a newspaper, magazine or similar medium of an announcement or what is technically known as a “card” is prohibited.⁵² Also prohibited is the issuance of a press release regarding firm mergers, opening of new offices, change of address or admission of new partners.⁵³

Announcements of such changes may be mailed to clients and individuals with whom professional contacts are maintained, such as lawyers and bankers.⁵⁴ Such announcements should be dignified and should not refer to fields of specialization.⁵⁵

502-2—Office premises. Listing of the firm name in lobby directories of office buildings and on entrance doors solely for the purpose of enabling interested parties to locate an office is permissible. The listing should be in good taste and modest in size.⁵⁶

The indication of a specialty such as “income tax” in such listing constitutes advertising.⁵⁷

502-3—Directories: telephone, classified and trade association.

A listing in a telephone, trade association, membership or other classified directory shall not:

1. Appear in a box or other form of display, or in a type or style which differentiates it from other listings in the same directory.⁵⁸

2. Appear in more than one place in the same classified directory.

3. Appear under a heading other than “Certified Public Accountant” or “Public Accountant” where the directory is classified by type of business occupation or service.⁵⁹

4. Be included in the yellow pages or business section of a telephone directory unless the member maintains a bona fide office in the geographic area covered. Determination of what constitutes

⁵² Rule 3.01.

⁵³ Opinion No. 9 (4).

⁵⁴ Opinion No. 11 (1a) (qualifying phrase, “lawyers of clients,” is dropped).

⁵⁵ Opinion No. 11 (1b).

⁵⁶ Opinion No. 11 (5a).

⁵⁷ Opinion No. 11 (5b).

⁵⁸ Opinion No. 11 (2a).

⁵⁹ Opinion No. 11 (2a(2)).

INTERPRETATIONS OF RULES OF CONDUCT

an "area" shall be made by referring to the positions taken by state CPA societies in the light of local conditions.⁶⁰

Such listing may:

1. Include the firm name, partners' names, professional title (CPA), address and telephone number.⁶¹

2. Be included under both the geographical and alphabetical section where the directory includes such sections.⁶²

502-4—Business stationery. A member's stationery should be in keeping with the dignity of the profession and not list any specialty.⁶³

The stationery may include the firm name, address and telephone number, names of partners, names of deceased partners and their years of service, names of professional staff when preceded by a line to separate them from the partners, and cities in which other offices and correspondents or associates are located.⁶⁴ Membership in the Institute or state CPA society or associated group of CPA firms whose name does not indicate a 'specialty may also be shown.⁶⁵ In the case of multi-office firms, it is suggested that the words "offices in other principal cities" (or other appropriate wording) be used instead of a full list of offices.⁶⁶ Also, it is preferable to list only the names of partners resident in the office for which the stationery is used.⁶⁷

502-5—Business cards. Business cards may be used by partners, sole practitioners and staff members. They should be in good taste and should be limited to the name of the person presenting the card, his firm name, address and telephone number(s), the words "Certified Public Accountant(s)," or "CPA" and such words as "partner," "manager" or "consultant" but without any specialty designation.⁶⁸

Members not in the practice of public accounting may use the title "Certified Public Accountant" or "CPA" but shall not do so

⁶⁰ Opinion No. 11 (2b).

⁶¹ Opinion No. 11 (2a(1)).

⁶² Opinion No. 11 (2c(2)).

⁶³ Opinion No. 11 (3a).

⁶⁴ Opinion No. 11 (3b(1 and 2)).

⁶⁵ New.

⁶⁶ Opinion No. 11 (3c).

⁶⁷ Opinion No. 11 (3c).

⁶⁸ Opinion No. 11 (4a).

1 when engaged in sales promotion, selling or similar activities.⁶⁹

2 **502-6—Help wanted advertisements.** A member shall not in-
3 clude his name in help-wanted or situations-wanted display adver-
4 tising on his own behalf or that of others in any publication. In
5 display advertising, the use of a telephone number, address, or
6 newspaper box number is permissible.⁷⁰

7 In classified advertisements other than display, the member's
8 name should not appear in boldface type, capital letters or in any
9 other manner which tends to distinguish the name from the body
10 of the advertisement.⁷¹

11 **502-7—Firm publications.** Newsletters, bulletins, house organs,
12 recruiting brochures and other firm literature on accounting and
13 related business subjects prepared and distributed by a firm for
14 the information of its staff and clients serve a useful purpose. The
15 distribution of such material outside the firm must be properly
16 controlled and should be restricted to clients and individuals with
17 whom professional contacts are maintained, such as lawyers and
18 bankers.⁷² Copies may also be supplied to job applicants, to stu-
19 dents considering employment interviews,⁷³ to nonclients who
20 specifically request them and to educational institutions.⁷⁴

21 If requests for multiple copies are received and granted, the
22 member and his firm are responsible for any distribution by the
23 party to whom they are issued.⁷⁵

24 **502-8—Newsletters and publications prepared by others.** A
25 member shall not permit newsletters, tax booklets or similar pub-
26 lications to be imprinted with his firm's name if they have not been
27 prepared by his firm.⁷⁶

28 **502-9—Responsibility for publisher's promotional efforts.** It is
29 the responsibility of a member to see that the publisher or others
30 who promote distribution of his writing, observe the boundaries
31 of professional dignity and make no claims that are not truthful

⁶⁹ Opinion No. 11 (4b).

⁷⁰ Opinion No. 11 (6a).

⁷¹ Opinion No. 11 (6b).

⁷² Opinion No. 9 (1) (qualifying phrase, "lawyers of clients," is dropped).

⁷³ New.

⁷⁴ Opinion No. 9 (1).

⁷⁵ Opinion No. 9 (1).

⁷⁶ Opinion No. 1.

INTERPRETATIONS OF RULES OF CONDUCT

and in good taste. The promotion may indicate the author's background including, for example, his education, professional society affiliations and the name of his firm,⁷⁷ the title of his position and principal activities therein.⁷⁸ However, a general designation referring to any specialty, such as "tax expert" or "tax consultant" may not be used.⁷⁹

502-10—Statements and information to the public press. A member shall not directly or indirectly cultivate publicity which advertises his or his firm's professional attainments or services. He may respond factually when approached by the press for information concerning his firm, but he should not use press inquiries as a means of aggrandizing himself or his firm or of advertising professional attainments or services. When interviewed by a writer or reporter, he is charged with the knowledge that he cannot control the journalistic use of any information he may give and should notify the reporter of the limitations imposed by professional ethics.⁸⁰

Releases and statements made by members on subjects of public interest which may be reported by the news media, and publicity not initiated by a member such as that which may result from public service activities, are not considered advertising. However, press releases concerning internal matters in a member's firm are prohibited.

502-11—Participation in educational seminars. Participation by members in programs of educational seminars, either in person or through audiovisual techniques, on matters within the field of competence of CPAs is in the public interest and is to be encouraged. Such seminars should not be used as a means of soliciting clients. Therefore, certain restraints must be observed to avoid violation of the spirit of Rule 502 which prohibits solicitation and advertising. For example, a member or his firm should not:

1. Send announcements of a seminar to nonclients or invite them to attend. However, educators may be invited to attend to further their education.
2. Sponsor, or convey the impression that he is sponsoring, a

⁷⁷ Opinion No. 4.

⁷⁸ New.

⁷⁹ Opinion No. 5.

⁸⁰ Restatement of Opinion No. 9 (4).

1 seminar which will be attended by nonclients. However, a member
2 or his firm may conduct educational seminars solely for clients
3 and those serving his clients in a professional capacity, such as
4 bankers and lawyers.

5 In addition, when a seminar is sponsored by others and attended
6 by nonclients, a member or his firm should not:

- 7 1. Solicit the opportunity to appear on the program.
- 8 2. Permit the distribution of publicity relating to the member
9 or his firm in connection with the seminar except as permitted
10 under Interpretation 502-9.
- 11 3. Distribute firm literature which is not directly relevant to a
12 subject being presented on the program by the member or persons
13 connected with his firm.⁸¹

14 **502-12—Solicitation of former clients.** Offers by a member to
15 provide services after a client relationship has been clearly termin-
16 ated, either by completion of a nonrecurring engagement or by
17 direct action of the client, constitute a violation of Rule 502 pro-
18 hibiting solicitation.⁸²

19 **502-13—Soliciting work from other practitioners.** Rule 502
20 does not prohibit a member in the practice of public accounting
21 from informing other practitioners of his availability to provide
22 them or their clients with professional services. Because advertis-
23 ing comes to the attention of the public, such offers to other prac-
24 titioners must be made in letter form or by personal contact.⁸³

25 **502-14—Fees and professional standards.** To quote a fee in
26 advance of an engagement in an amount clearly inadequate to pro-
27 vide fair compensation for performing service in accordance with
28 accepted professional standards may be regarded, in some circum-
29 stances, as evidence of solicitation in violation of Rule 502 of the
30 Code of Professional Ethics. Without attempting to specify all cir-
31 cumstances that might be relevant in determining the propriety of
32 a particular quotation, it would be appropriate to consider whether
33 there were any facts suggesting that such inadequate fee had been
34 fixed as a part of a plan or design to solicit business.⁸⁴

⁸¹ Opinion No. 21.

⁸² Restatement of Opinion No. 20.

⁸³ Restatement of Opinion No. 7.

⁸⁴ Opinion No. 18.

INTERPRETATIONS OF RULES OF CONDUCT

Interpretation under Rule 505—Form of practice and name

505-1—Investment in commercial accounting corporation. A 3
member in the practice of public accounting may have a financial 4
interest in a commercial corporation which performs for the public 5
services of a type performed by public accountants and whose char- 6
acteristics do not conform to resolutions of Council, provided such 7
interest is not material to the corporation's net worth, and the 8
member's interest in and relation to the corporation is solely that 9
of an investor.⁸⁵ 10

⁸⁵ Opinion No. 7.

Committee on Code Restatement

Wallace E. Olson, <i>Chairman</i>	Thomas G. Higgins
George D. Anderson	John Peoples
Ivan Bull	John R. Ring
Clifford E. Graese	John W. Zick

Consultants and Former Members of the Committee

Thomas D. Flynn	— <i>Chairman, Division of Professional Ethics (1968-1970)</i>
Herbert E. Miller	— <i>Member of committee (1969-1970)</i>
James VanderLaan	— <i>Member of committee (1968-1969)</i>
John L. Carey	— <i>Retired Administrative Vice President, AICPA</i>
Stewart Schackne	— <i>Public relations consultant, AICPA</i>
Donald J. Schneeman	— <i>Director, Division of Professional Ethics</i>